Supreme Court, U.S.

No. 98 1341 OCT 29 1998

OFFICE OF THE CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term 1998

RICHARD H. BLUM and EVA M. BLUM,
Petitioners,

v.

STATE FARM FIRE AND CASUALTY COMPANY and
STATE FARM GENERAL INSURANCE COMPANY,
Respondents.

Petition for Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

JOHN B. KEATING, ESQ.
Post Office Box 620622
2995 Woodside Road,
Woodside, CA 94062
(650) 851-5900
Counsel of Record for Petitioners

BRIAN B. BECKWITH, ESQ
Post Office Box 620628
2995 Woodside Road,
Woodside, CA 94062
(650) 851-4782
Counsel for Petitioners

QUESTIONS PRESENTED

1. Is an insurance policy defense duty obligation for independent tort liability always precluded if a real estate sale contract relationship also exists?

2. Does the Memorandum Decision of the Ninth Circuit Court of Appeals improperly depart from the normal course of judicial proceedings in:

   A. allowing an improper unfair presumption that sidesteps the thorough analysis controlling California law requires for determining the defense duty obligation of an insurance company;

   B. concluding that construction defect litigation could present no potential for tort liability independent of a contractual relationship;

   C. affirming a motion to dismiss decision without disposing of all forms of liability pled in the coverage action;

   D. affirming a motion to dismiss decision prior to discovery despite an allegation in the complaint that the insurance company would not voluntarily disclose additional insurance policies that were relevant to the defense duty obligation at issue; and

   E. affirming a decision denying a request for leave to amend despite

the prematureness of dismissal without leave to amend upon the first challenge to the pleading and despite the offer of amendment to clarify the basis of the liability?

3. Is the conclusion that the defective removal was properly excused inconsistent with controlling law in allowing disfavored diversity jurisdiction in an action removed by an insurance company without strict compliance with the removal procedural requirements?

LIST OF PARTIES

The parties to the proceedings in the Court of Appeals were as follows:

Plaintiffs/Petitioners were RICHARD H. BLUM and EVA M. BLUM. Plaintiffs/Petitioners have no corporate affiliation.

Defendants/Respondents were STATE FARM FIRE AND CASUALTY COMPANY and STATE FARM GENERAL INSURANCE COMPANY.

TABLE OF CONTENTS

QUESTIONS PRESENTED ii

LIST OF PARTIES iv

TABLE OF CONTENTS v

TABLE OF AUTHORITIES viii

PETITION 1

OPINIONS BELOW 2

STATEMENT OF BASIS OF JURISDICTION 2

STATUTES INVOLVED IN THE CASE 3

STATEMENT OF THE CASE 5

1. Introduction 5

2. The Basic Insurance Coverage Controversy 8

3. The Tender And Procedural History 9

REASON FOR GRANTING THE WRIT 12

1. The General Legal Conclusion of the Decision Is Appropriate for Review Because It Departs From the Controlling California Law Requiring Detailed Analysis of the Source of the Liability Producing Duty and Misapplies California Coverage Law In That Existence of a Real Estate Sale Does Not Preclude Trigger of a Defense Duty Obligation for Independent Negligent Construction Liability and Absolute Liability of the Prior Owner. 12

2. The General Legal Conclusion of the Decision Is Appropriate for Review Because It Departs From the General Law As Interpreted and Applied by Federal Courts of Appeals in Other Circuits 16

3. Review is Warranted Because Even If The Expansive Application of the "Legally Liable" Language Were Otherwise Appropriate, The Application Is Not Appropriate In This Case Because the Language Does Not Appear In the Policy Coverage Provisions At Issue 17

4. The Decision's Apparent Assumption of the Existence of a Contractual Relationship Underpinning to the Duty Is Factually Mistaken in That There Was No Such Contractual Relationship. 18

5. All Aspects of The Negligence Claims Are Not Exclusively Based on The Same Facts as the Disclosure Claims 19

6. An Insurer May Have a Duty to Defend a Claim for Negligence Despite the Presence of Other Claims for Misrepresentation or Breach of Contract 20

7. The Memorandum Decision Appears to Overlook and the Reasoning Would Not Preclude a Defense Duty Arising from the Potential Exposure to Absolute Liability. 21

8. The Request For Leave to Amend Should Not have Been Overlooked. 22

9. The Memorandum Decision Overlooks the Prematureness and Incompleteness of the Dismissal Motion 23

10. The Conclusion That the Defective Removal Was Properly Excused Is Inconsistent with the Controlling Law That a Party Seeking to Gain Advantage by Removal Is Put to the Test of Precise Compliance with the Federal Rules of Civil Procedure. 25

CONCLUSION 29

APPENDIX Ap.1

Denial of Petition for Rehearing Ap.2

Published Court of Appeal Judgment Ap.3

Unpublished Court of Appeal Decision Ap.4

Unpublished District Court Decision Ap.12

TABLE OF AUTHORITIES

Cases **Pages**

AIM Insurance Company v. Culcasi (1991)
229 Cal. App. 3d 209 Cal. Rptr 766. . 20

AIU Ins. Co. v. Superior Court (1990)
51 Cal. 3d 807, 274 Cal. Rptr. 820,
700 P.2d 1253 13-15

Allstate Insurance. Co. v. Hansten,
(N.D. Cal 1991)765 F. Supp. 614 . . . 19

American Casualty Co. v. Timmons
(6th Cir. 1965)352 F.2d 563 17

Buss v. Superior Court (Transamerica)
(1997)16 Cal. 4th 35,
939 P.2d 766, Cal. Rptr. 2d 366 . 15,24

Cheek v. Williams-McWilliams Co.
(5th Cir. 1983) 697 F.2d 649 17

Cuttle v. Federal Employees Metal Trades
Council,(D.Me. 1985)
623 F.Supp 1154. 27

Colonial Refrigerated Transportation v.
Worsham (6th Cir 1983)
705 F.2d 821 17

Doe v. Kerwood (5th.Cir. 1992)
969 F.2d 165 27

Driver v. Gindy Manufacturing Corporation,
(E.D.Pa. 1959)24 F.R.D. 473 28

Fragomeno v. Insurance Co. of the West (1989)
207 Cal. App. 3d, 255 Cal. Rptr . . . 16

General Cas. Of Wisconsin v. Larson
(8th Cir. 1952)196 F.2d 170 17

Kyle v. Campbell Soup Company,
(9th Cir. 1994)13 F.3d 317 28

Larson v. General Cas. Of Wisconsin
(D.Minn 1951) 99 F.Supp. 300 17

Link v. Wabash R. Co. (1962)
370 U.S. 626 28

Lumbermens Mutual Cas. Co. Town of Pound Ridge
(2nd Cir.) 362 F.2d 430 17

Miller v. Western General Agency, Inc.,(1996)
41 Cal. App. 4th 1144 20-21

Munoz v. Small Business Administration,
(9th Cir. 1981)644 F.2d 1361, ... 3

Pioneer Investment Services Company v.
Brunswick, (1993)
507 U.S. 380, 113 S.Ct. 1489, 123
L.Ed.2d 74 28

Ritchie v. Anchor Cas. Co., (1955)
135 Cal. App. 2d 245,
286 P.2d 1000 20

Safeco Insurance Co. of America v. Andrews,
(9th Cir. 1990)915 F.2d 500 . . . 20,21

Savarese v. Edrick Transfer and Storage, Inc.
(9th Cir. 1975)513 F.2d 140 26

Simmons Co. v. The Fidelity and Casualty Co.
(7th Cir. 1975) 511 F.2d 87 17

Stanford Ranch, Inc. v. Maryland Casualty Co., (9th Cir. 1996)89 F.3d 16,21

Terracom v. Valley National Bank, (9th Cir. 1995)49 F.3d 555 23

United States v. Boyle (1985) 469 U.S. 241 28

United States Fidelity & Guar. Co. v. Virginia Engg (4th Cir. 1954) 213 F.2d 109 17

Vandenberg v. Sacramento County Superior Court, (March 25, 1998, SO67115) 953 P. 2d 158, 73 Cal.Rptr. 2d 195, 98 Cal. Daily Op. Service 2204, 1998 Cal. LEXIS 1825 14

Vandenberg v. Superior Court (Centennial Insurance) (1997) 59 Cal. App. 4th, 69 Cal. Rptr.2d 511 13-15

Waller v. Truck Insurance Exchange (1995) 11 Cal. 4th 1, 900 P. 2d 619 13

Statutes:

United States Code Sections:

28 U.S.C. § 1254(1) 3
28 U.S.C. § 1291 2
28 U.S.C. § 1332 2
28 U.S.C. § 1441(b) 2
28 U.S.C. § 2107(a) 3

Rules: **Page**

Federal Rules of Appellate Procedures:

Rule 4(a) 3
Rule 28(j) 14

Federal Rules of Civil Procedure:

Rule 6 (b) 27,28
Rule 15(a) 22
Rule 55(a) 27
Rule 81(c) 26,28

Supreme Court Rules:

Rule 13.3. 3

IN THE
SUPREME COURT OF THE UNITED STATES

October Term 1998

RICHARD H. BLUM and EVA M. BLUM,
Petitioners,

v.

STATE FARM FIRE AND CASUALTY COMPANY and
STATE FARM GENERAL INSURANCE COMPANY,
Respondents.

Petition for Writ of Certiorari to the
United States Court of Appeals for the Ninth Circuit

PETITION FOR WRIT OF CERTIORARI

Petitioners Richard H. Blum and Eva M. Blum respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit in *Richard H. Blum et al. v. State Farm Fire and Casualty Company et al.*, 145 F.3d 1336 (May 19, 1998).

OPINIONS BELOW

The DECISION WITHOUT PUBLISHED OPINION of the United States Court of Appeals for the Ninth Circuit (May 19, 1998) is reported at 145 F.3d 1336, and is reproduced in the Appendix at page Ap.3. The unpublished MEMORANDUM Opinion of the United States Court of Appeals for the Ninth Circuit (May 19, 1998) is unreported and is reproduced in the Appendix at page Ap.4. The Order Denying Petition for Rehearing by the United States Court of Appeals for the Ninth Circuit (July 31, 1998) is unreported and is reproduced in the Appendix at page Ap.2.

The July 17, 1996 ORDER OF DISMISSAL decision of the United States District Court for the Northern District of California (No. C 96-0259 CAL) is unreported and is reproduced in the Appendix at page Ap.12.

STATEMENT OF BASIS OF JURISDICTION

The District Court had subject matter jurisdiction on the basis of diversity jurisdiction under 28 U.S.C. § 1332 and presumed removal jurisdiction under 28 U.S.C. § 1441(b) although petitioners contend the removal was procedurally defective.

The District Court's orders dismissing the First Amended Complaint without leave to amend and denying the motion to vacate the judgment were reviewable in the Court of Appeal as final decisions of the District Court. 28 U.S.C. § 1291. The District Court's acts of declining to enter default and

enlarging time to respond were reviewable as interlocutory decisions merged into the final judgment. Munoz v. Small Business Administration, 644 F.2d 1361, 1364 (9th Cir. 1981). The District Court's order dismissing the complaint and judgment thereon were entered on July 23, 1996. Petitioners filed a motion to vacate the judgment on July 31, 1996. The District Court's order denying the motion to vacate was entered on October 3, 1996.

Petitioners filed a notice of appeal with the District Court on October 11, 1996. The appeal to the Court of Appeals for the Ninth Circuit was timely under 28 U.S.C. § 2107(a) and Federal Rule of Appellate Procedure 4(a). The Court of Appeals for the Ninth Circuit rendered its unpublished Memorandum Decision on May 19, 1998 and entered its Order denying the Petition for Rehearing on July 31, 1998.

The Supreme Court has jurisdiction on this Petition for Writ of Certiorari pursuant to 28 U.S.C. § 1254(1). This Petition for Writ of Certiorari is timely under Supreme Court Rules, Rule 13.3.

STATUTES INVOLVED IN THE CASE

Federal Rule of Civil Procedure 6(b)
Time Enlargement

When by these rules or by a notice given thereunder or by order of court an act is required or allowed to be done at or within a specified time, the court for cause shown may at any time in its discretion (1) with or

without motion or notice order the period enlarged if request therefore is made before the expiration of the period originally prescribed or as extended by a previous order, or (2) upon motion made after the expiration of the specified period permit the act to be done where the failure to act was the result of excusable neglect; but it may not extend the time for taking action under Rules 50(b) and (c)(2), 52(b), (d) and (e), 60(b), and 74(a), except to the extent and under the conditions stated in them.

Federal Rule of Civil Procedure 12(b)(6)
Defenses and Objections - How Presented

Every defense, in law or fact, to a claim for relief in any pleading, whether a claim, counterclaim, cross-claim, or third-party claim, shall be asserted in the responsive pleading thereto if one is required, except that the following defenses may at the option of the pleader be made by motion: . . . (6) failure to state a claim upon which relief can be granted, . . . If, on a motion asserting the defense numbered (6) to dismiss for the failure of the pleading to state a claim upon which relief can be granted, matters outside the pleading are to be presented to and not excluded by the court, the motion shall be treated as for one summary judgement and disposed of as in Rule 56, and parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Federal Rule of Civil Procedure 55(a)
Default - Entry

When a party against whom a judgment for affirmative relief is sought has failed to plead or otherwise defend as provided by these rules and that fact is made to appear by affidavit or otherwise, the clerk shall enter the party's default.

Federal Rule of Civil Procedure 81(c)
Removed Actions

. . . In a removed action in which the defendant has not answered, the defendant shall answer or present the other defenses or objections available under these rules within 20 days after the receipt through service or otherwise of a copy of the initial pleading setting forth the claim for relief upon which the action or proceeding is based, or within 20 days after the service of summons upon such initial pleading, then filed, or within 5 days after the filing of the petition for removal, whichever period is longest.

STATEMENT OF THE CASE

1. Introduction

The decision in this case sanctions federal court departure from the long-standing rule that an insurance company must provide its policyholder with defense of a tendered lawsuit if there is potential that <u>any</u> claim in the lawsuit could result in liability covered by the policy.

The controlling law requires careful independent analysis of every potential claim in an underlying action prior to denial of an

insurance company's defense obligation.

Specifically, California insurance coverage law requires defense of a tort claim even if the tort duty arises in connection with an excluded contract claim unless there is no potential that the tort duty could arise without a contract duty underpinning.

The decision by the Court of Appeals in this case changes that basic requirement in finding that an independent tort claim did not exist when combined with real estate contract disclosure claims. That new approach allows an unreasonable policy interpretation presumption sought by insurance companies, to summarily conclude there is no defense as to any cause of action merely because some of the claims arise from excluded contractual duty.

The lawsuit against the Blums included claims for negligence in construction occurring over a decade prior to the real estate transaction. It also sought strict liability for the defects. The insurance policies cover such potential tort liability. Therefore, a defense duty arose.

The insurance company refused to defend based on an assumption that the tort claims sound exclusively in contract because the claims were brought by a subsequent owner after a real estate transaction. However, the mere presence of additional causes of action for contract and real estate disclosure liability does not ordinarily allow an insurance company to avoid the required careful analysis of its duty to defend the

tendered independent tort claims.

The Court of Appeal decision approved the insurance company denial of the defense duty, finding "Specifically, the duty element in both claims could only arise from the contractual relationship." See Memorandum Decision at Appendix page 6. The Memorandum Decision analyzes the negligence claim as only relating to disclosure and misrepresentation. It does not refer to consideration of the negligent construction and strict liability aspect.

That presumption that the negligence claim can only arise from the contractual relationship is contrary to construction liability law, is contrary to the general parameters of the duty to defend a covered claim regardless if other claims are excluded, and is contrary to the analysis duty ordinarily owed under insurance policies.

The consequence is inconsistent judicial determinations - the nightmare experienced by the insureds in this case of being held responsible in one forum for a certain type of liability but losing their insurance protection because of determination in another forum that such liability is impossible. Despite the conclusion of the coverage litigation that there could be no independent non contract liability, the insureds in fact paid a judgment for such tort liability in the underlying action, doing so after defeating and disposing of all contract based claims.

Petitioners submit that the anomalous

result is the product of the insurance industry's repeated efforts to persuade courts to skip the rigors of full defense duty analysis, and instead make decisions based on convenient coverage restricting assumptions. The decision is contrary to the specific language of the policy. Even were the insurance company's analysis as adopted by the Court of Appeal correct as to the indemnity "coverage" under the policy, the relied upon analysis is not applicable to the policy's separate defense duty obligation language.

The federal court intervention in the state coverage law standards was unnecessary in this case as the district court might have properly remanded the action back to state court based on the defective removal or could have allowed the requested leave to amend to further specify the independent coverage grounds. The premature decision occurred although some of the issues are currently on review before the California Supreme Court.

2. The Basic Insurance Coverage Controversy

The Blums constructed a house in 1969 and made modifications in 1974. They sold the house in late 1986. Ownership of the house was then transferred several times, and ultimately went through gift to the final owners. Those final owners brought the underlying action two decades later in 1992 after discovering certain defects attributed to the 1969 and 1974 constructions and finding that fuel storage tank lines over time had leaked some petroleum product into the wall of

the house. The defects and fuel leaks were hidden in the walls and unknown to the Blums.

Nevertheless, the giftee ultimate owners and the interim owners sued the Blums in a mixed action, asserting claims based on the negligent construction and absolute liability of the Blums as the owner/builders, and also myriad contract and disclosure claims for the failure of the Blums to have identified the unknown defects during the sale years later.

The Blums contend that a defense was owed because of the potential liability for breach of the tort duties existing in 1969 and 1974, and in light of the exposure to other negligence liability and absolute liability existing independently of the contract and disclosure claims. The insurance company contends there was no defense obligation based on its view that there could be no liability other than contract and disclosure liability arising from the real estate transaction.

3. The Tender and Procedural History

After the Blums tendered defense of the mixed action, the insurance company delayed coming to conclusion on the defense funding for three quarters of a year, in the interim writing that there were "profound coverage questions." Ultimately, the insurance company denied the defense obligation. It characterized the defect litigation as arising exclusively from the real estate sale, and on that basis denied the defense duty tender as to even the tort claims under a misconception that all potential claims arose from contract.

The Blums repeatedly sought to convince the insurance company to comply with the California case law duty to independently evaluate the existence of the potential tort liability rather than simply summarily concluding that all liability arose from the sales contract, to no avail.

Defending the litigation themselves, the Blums ultimately defeated all of the contract and failure to disclose based claims, and prevailed in defending all claims of the intervening owners, the only parties who were in contractual privity. However, the Blums were ultimately held liable on the independent tort and strict liability claims, and suffered judgment in the amount of the defects.

The Blums then brought this coverage action in State court, seeking to force the insurance company to address the coverage for the independent tort liability for the negligent construction and the absolute liability, and to force the insurance company to provide the remaining relevant insurance policies. The insurance company did not do so. Instead, it removed the action and brought a motion to dismiss. By binging the motion to dismiss prior to the opening of discovery, the insurance company avoided providing the remaining insurance policies.

The motion to dismiss largely argued against coverage for the contract and misrepresentation claims (a red herring in that the Blums had never claimed such coverage under the policies) and then argued that the tort claims all arose from the contract or

misrepresentation-based claims.

The Blums opposed the motion on the primary basis that a defense duty existed because the tort claims and absolute liability claims could exist, as they in fact did, after all of the real estate sales contract related claims were disposed of; that California defense duty law requires thorough analysis of whether there was any possibility that the negligence claims could exist independently from the sales transaction claims; that leave to amend to more fully allege the independent tort liability facts was appropriate; that the motion to dismiss could not be decided in light of the factual issues necessary for determination; and that the motion to dismiss could not be decided prior to disclosure of all the relevant policies. The Blums also argued that they presented other claims against the insurance company that did not depend on prevailing on the defense duty.

Nevertheless, the District Court concluded that all potential liability arose from the contractual transaction, granted the motion to dismiss and denied the request for leave to amend to particularly plead additional defense duty trigger facts. The Court of Appeal affirmed, also concluding that the tort claims arose from the contract duty.

/ / /

/ / /

/ / /

REASON FOR GRANTING THE WRIT

1. The General Legal Conclusion of the Decision Is Appropriate for Review Because It Departs From the Controlling California Law Requiring Detailed Analysis of the Source of the Liability Producing Duty and Misapplies California Coverage Law in That Existence of a Real Estate Sale Does Not Preclude Trigger of a Defense Duty Obligation for Independent Negligent Construction Liability and Absolute Liability of the Prior Owner.

The insurance company position and Court of Appeals' decision construe the "legally liable" language of the first paragraph of the coverage grant of the insurance policy to restrict coverage to damages arising from *ex delicto* as opposed to *ex contractu* claims.

Federal courts siting in California have increasingly construed the language "legally liable" to preclude coverage not only for contract damages in contract causes of action, but also to preclude coverage of tort claims arising from a contractual duty. The standard previously applied was determination of the source of the duty - whether the liability creating tort duty could stand on its own absent a contractual duty.

In this case, the application of the "legally liable" language was greatly expanded such as to preclude any coverage at all if there happened to be a contractual relationship, regardless of whether the liability creating duty actually arose from a

tort duty or a contractual duty. That expansion deviates from California law and the law as applied by other federal Courts of Appeals, which generally holds that coverage of a tort claim is not precluded by the "legally liable" language unless the tort duty depends for existence on a contractual duty.

The opinion in Vandenberg v. Superior Court (Centennial Insurance), (1997) 59 Cal. App. 4th 898, 69 Cal. Rptr. 2d 511, clarifies the application of the California Supreme Court authority of Waller v. Truck Insurance Exchange (1995) 11 Cal.4th 1, 17, 900 P. 2d 619 and AIU Ins. Co. v. Superior Court (1990) 51 Cal. 3d 807, 819, 274 Cal.Rptr. 820, 799 P.2d 1253, as controlling California law contrary to the Decision rendered in this case. California law provides that the mere existence of a contractual relationship does not preclude the defense duty obligation, but that the analysis must properly determine whether there is any possibility of liability not dependent on the existence of a contract. (Vandenberg, 59 Cal App. 4th at 911-913 citing the California Supreme Court authority holding that the general rule that coverage extends to tort damages only "is not a universal bar to insurance coverage wherever a contract is involved.") The Vandenberg opinion analysis at page 912 concludes: "However, the general rule is not a universal bar to insurance coverage whenever a contract is involved. *(Waller v. Truck Ins. Exchange., supra 11 Cal. 4th at p. 17)*"

The Vandenberg case was decided after argument of this case, but was submitted as

supplemental authority pursuant to Federal Rules of Appellate Procedure, Rule 28(j). This further authority relates to the conclusion made in the Memorandum Decision at page 3. It clarified that California law supported the Blums' position that the "legally liable" language of the policy did not universally preclude all coverage where a "contract" claim is also involved in the underlying action. The Vandenberg decision at page 913 emphasized the conclusion of AIU that rejected a strict form of remedy approach in response to an insurer's similar contention that the environmental response costs were not "damages" for which the insured had become "legally obligated to pay."

The California Supreme Court granted review of the Vandenburg case (Vandenberg v. Sacramento County Superior Court, (March 25, 1998, SO67115) 953 P. 2d 158, 73 Cal.Rptr. 2d 195, 98 Cal. Daily Op. Service 2204, 1998 Cal. LEXIS 1825), but limited the issues on review to "1) Whether a general liability insurance policy may never provide an insured defendant with coverage for losses that are plead by the plaintiff as breaches of contract and 2) Whether commercial arbitration decisions have collateral estoppel effect."

The Vandenburg Court of Appeal decision had also ruled that even if the claims are plead as contract damages they may implicate coverage. Vandenberg at 913. The Supreme Court limited review of that specific conclusion of the case leaves intact the remaining general portion of the opinion regarding contract related circumstances where

the claim is pled in tort - that the mere fact that a contract is involved does not preclude all defense duty obligation for otherwise tort based liability. Therefore the Vandenberg case, and its recital of the controlling California Supreme Court case law, clarifies that defense of the negligence claims in this case was not properly withheld merely because the parties would not have been involved with one another but for a sales contract.

In Buss v. Superior Court (Transamerica) (1997) 16 Cal.4th 35, 939 P.2d 766, 65 Cal.Rptr. 2d 366, the California Supreme Court ruled on the duties in similar circumstances of defense duty dispute concerning mixed tort/contract cases. Buss concerned twenty seven causes of action related to performance of various contracts. Amongst the contract claims, misrepresentation claims and interference with contract claims was a related claim for defamation. The defamation claim triggered a defense duty despite arising in the context of a contractual relationship.

Similarly, AIM Insurance Company v. Culcasi (1991) 229 Cal. App. 3d 209, 216, 280 Cal. Rptr. 766, 769-770 establishes that a tort duty liability can trigger a defense duty even if the same act is required to be performed pursuant to a contractual relationship. A defense duty is owed if there is any possibility the insured could face liability for the tort duty breach.

Hence, California coverage law clearly provides that careful analysis of the defense duty obligation must be conducted with regard

to whether there is any possibility that any of the claims in the litigation could result in covered liability. California case law concludes that the existence of the contract itself is not the end of the story, but rather is a factor that triggers more detailed analysis as to whether the alleged tort duty is completely dependent on a contractual duty.

The cases recited in the Memorandum Decision in avoiding the analysis requirement are in fact contrary to that conclusion. Each involves analysis of the issue of whether the particular tort liability could arise from an independent tort duty or truly can arise only as a result of the contractual duty. In both Stanford Ranch, Inc. v. Maryland Casualty Co., (9th Cir. 1996) 89 F.3d 618 and Fragomeno v. Insurance Co. of the West (1989) 207 Cal. App. 3d 822, 255 Cal. Rptr. 111 the courts carefully analyzed the duty at issue, and after the analysis concluded that there was no potential in those circumstances for independent tort liability of the contracting party. Implicit in that analysis is a conclusion that it is not proper to summarily conclude that defense duty is avoided merely because of a contractual relationship.

2. The General Legal Conclusion of the Decision Is Appropriate for Review Because It Departs From the General Law As Interpreted and Applied by Federal Courts of Appeals in Other Circuits

The interpretation of the Memorandum Decision limiting the scope of coverage afforded by general liability insurance

policies is inconsistent with the policy construction applied by the Federal Courts of Appeals in other jurisdictions that tort duty liability claims trigger a defense duty even if arising in the context of a contractual relationship. Lumbermens Mutual Cas. Co. Town of Pound Ridge 362 F.2d 430, 434 (2nd Cir.); United States Fidelity & Guar. Co. v. Virginia Engg 213 F.2d 109 (4th Cir. 1954); Cheek v. Williams-McWilliams Co. 697 F.2d 649, 656 (5th Cir. 1983); Colonial Refrigerated Transportation v. Worsham 705 F.2d 821, 826-7 6th Cir 1983); American Casualty Co. v. Timmons 352 F.2d 563, 568 (6th Cir. 1965); Simmons Co. v. The Fidelity and Casualty Co. 511 F.2d 87, 91 (7th Cir. 1975); Larson v. General Cas. Of Wisconsin 99 F.Supp. 300 (D.Minn 1951) aff'd General Cas. Of Wisconsin v. Larson 196 F.2d 170, 174 (8th Cir. 1952).

Generally, coverage of claims arising from contract duties is not restricted where the damages are not awarded under a breach of contract theory. Larson v. General Cas. Of Wisconsin 99 F.Supp. 300, 302 (D.Minn 1951) aff'd General Cas. Of Wisconsin v. Larson 196 F.2d 170, 174 (8th Cir. 1952).

3. **Review is Warranted Because Even If the Expansive Application of the "Legally Liable" Language Were Otherwise Appropriate, The Application Is Not Appropriate in This Case Because the Language Does Not Appear in the Policy Coverage Provisions at Issue.**

The "legally liable" language at issue appears only in the first clause of the

coverage grant, the paragraph providing the indemnity obligation. It does not appear in the second clause regarding the defense duty. Therefore, even if the expansive application given to the "legally liable" language were correct, satisfaction of that standard is not a precondition to the express language of the contractual defense duty.

4. The Decision's Apparent Assumption of the Existence of a Contractual Relationship Underpinning to the Duty Is Factually Mistaken in That There Was No Such Contractual Relationship.

The Memorandum Decision does not evidence any consideration of the Blums' key argument that there was no privity of contract, and thus no contract duty. The conclusion of the Memorandum Decision at the last line of page 2 through the first two lines of page 3 states "specifically, the duty element in both claims could only arise from the contractual relationship." That cannot be correct logically because there was no contractual relationship in existence as to the parties relevant to the tendered defense duty. All contract based liability and misrepresentation-based liability was disposed of prior to the arbitration award, and all parties with standing to pursue a contract-based claim were eliminated from the action prior to the arbitration award.

/ / /

/ / /

5. All Aspects of The Negligence Claims Are Not Exclusively Based on The Same Facts as the Disclosure Claims

The Memorandum Decision at page 4 is based on a mistaken conclusion that all of the negligence claimed in the underlying complaint was based on the same facts as the disclosure and misrepresentation claims. That is not the complete story. Under California law, the defense duty analysis is to be conducted based on whether any claims might exist that might result in covered liability, not whether some aspect of a claim that does exist might be barred. Hence, even if some of the negligence claims had a component related to the disclosure issues, that does not eliminate the defense duty triggering facts of the other aspects of the negligence liability regarding the construction occurring decades before.

The distinction is made more clear by the consideration of the type of construction duty at hand. The Memorandum Decision in the second paragraph of page 4 appears to not have benefitted from full analysis of the distinction between the facts of this case and the facts of the cited Allstate Insurance. Co. v. Hansten 765 F.Supp. 614 (N.D. Cal 1991)case. In citing Hansten, the Decision at the second paragraph of page 4 summarily concludes the Hansten case was "(reaching the same conclusion on identical facts)." However, the facts in Hansten were different from the facts in this case. Hansten involved a build-out contract. Hence, the construction at issue was performed pursuant to a duty created by the sales contract, and any

negligent construction liability in that case would in fact have arisen from breach of the build-out contract. In the Blum case the construction for which the Blums were held liable occurred a decade and a half prior to the real estate sales contract, not as a result of a build out contract obligation. Their duty to perform the construction properly existed in 1969 and 1974. It logically cannot be said that a duty to perform in 1974 arises from a contractual relationship existing in 1986.

6. **An Insurer May Have a Duty to Defend a Claim for Negligence Despite the Presence of Other Claims for Misrepresentation or Breach of Contract.**

Further, California courts have recognized coexistent tort and contractual duties in the context of liability insurance coverage. See AIM Ins. Co. v. Culcasi, 229 Cal.App.3d 209, 216-217, 280 Cal.Rptr. 766 (1991) (employer's contractual duty to employee irrelevant for liability insurance coverage purposes where employer also voluntarily undertook duty to deliver health insurance application on behalf of employee); Ritchie v. Anchor Cas. Co., 135 Cal.App.2d 245, 254-257, 286 P.2d 1000 (1955) (claims for breach of warranty implied by law covered regardless of related claims for breach of express warranty).

The insurance company relied on Miller v. Western General Agency, Inc., 41 Cal.App.4th 1144 (1996) and Safeco Insurance Co. of America v. Andrews, 915 F.2d 500 (9th Cir.

1990,). However, Miller and Andrews are distinguishable in that in those cases there were no allegations the insured was directly responsible for creating the defects. Rather, those cases focused on failure to disclose and misrepresentation. The Blums, in comparison, were sued in part because they allegedly directly caused the defects.

The principle that was articulated in the most recent published Ninth Circuit opinion addressing the issue was that "[i]f a claim is dependent upon the existence of an underlying contract, the claim sounds in contract, as opposed to tort." Stanford Ranch, 89 F.3d at 618 (emphasis added). Applying this standard to the negligent construction and defect claims against the Blums, it is clear that the claims were not dependent on the sales contract.

7. **The Memorandum Decision Appears to Overlook and the Reasoning Would Not Preclude a Defense Duty Arising from the Potential Exposure to Absolute Liability.**

The conclusions reflected in the Memorandum Decision do not and would not dispose of the duty to defend the absolute liability claim facts present in the underlying action. As the Blums were potentially liable for the fuel line and storage tank leakage damages, both as the prior owners of the property and as the builders of the improvements, such liability would not necessarily arise from the subsequent contract. The liability could exist independently due to the Blums' owner status.

8. **The Request for Leave to Amend Should Not have Been Overlooked.**

The Blums requested but were not granted leave to amend to assert the defense duty triggering facts with more particularity. Such leave to amend should be freely given.

The Motion to Dismiss decision was based in part on the court's conclusion that negligent construction liability of a former owner cannot exist independently of sales contract liability. The Court at hearing had inquired as to what happened at the binding arbitration of the underlying action. In addition to arguing that case law established that liability of a former owner can exist independently of the contract of sale and that proper defense duty analysis requires determination in the particular case as to whether the tort liability is independent, the Blums sought to submit evidence in the form of the recently received transcript of the final day of arbitration of the underlying action. That transcript showed that the liability of the Blums for negligent construction was indeed adjudicated in the underlying action, and that their liability could not arise from contract as there was no privity of contract.

Even if the allegations in the pleading before the District Court were insufficient, the Blums should have been granted at least one opportunity to amend their complaint to more particularly assert the existence of the independent tort liability basis for a duty to defend. See Fed.R.Civ.Proc. 15(a) ["leave shall be freely given when justice so

requires."]

9. The Memorandum Decision Overlooks the Prematureness and Incompleteness of the Dismissal Motion

A motion to dismiss must resolve all claims of the litigation and must test the sufficiency of the complaint assuming the truth of the allegations.

> "'A complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.' [citation]. In applying this standard, we assume that all of (plaintiff's) allegations are true. [citation]."
>
> Terracom v. Valley National Bank, 49 F.3d 555, 558 (9th Cir. 1995).

The District court did not properly apply that standard as it considered only a subset of the facts and liability theories alleged in support of the Blum's coverage action.

The Motion to Dismiss did not address all of the coverage theories presented or sought to be presented. The Blums had alleged there was a duty to defend them based both on the complaint and on other facts at issue in the underlying action. By disposing of the action on the initial motion to dismiss without leave to amend, the other defense duty trigger facts of the underlying action were not analyzed.

Moreover, the District Court did not consider all of the policies at issue. In this case, the Blums complain of the refusal of the insurance company to provide copies of relevant policies that the Blums contend would trigger a defense duty. The Court's ruling was based on an interpretation only of the insurance policies attached to the complaint. Those policies provided coverage from August 1985 to March 1995. However, at paragraph 14 of their complaint, the Blums allege that they were informed and believed that the insurance company also had issued insurance policies to them prior to August 1985 which would be relevant to the defense duty and that they had requested but had not received copies of the policies. The court was aware of that fact.

The decision does not consider the prematureness of a motion to dismiss prior to the opening of discovery when policyholders such as the Blums would finally be empowered to force the insurance company to disclose the remaining relevant policies. Adjudication without considering all of the potentially relevant policies resulted in the anomalous result that an insurance company could get away with avoiding its defense duty by withholding the relevant policies and then succeeding on a motion to dismiss prior to the time in which the court would protect the insured by requiring the policies be produced.

The Blums also alleged liability of the insurance company for the long delay in coming to a conclusion on whether a defense duty was owed. As stated in Buss, supra., 16 Cal.4th at 48-49, "To defend meaningfully, the insurer

must defend immediately." The Motion to Dismiss did not dispose of that claim for damage due to the delay. The Blums claim corollary non monetary harm other than failure to pay defense fees and delay in receipt of the payments.

The insurance company engages in deceitful conduct damaging to its insureds in misrepresenting to the insureds that it has no duty to defend in the interim of the excessive delay before it resolves its factual uncertainties on the defense duty. If the company is not able to decide conclusively during the initial period that is critical to the insured's defense, then it cannot during that time meet its burden of conclusively establishing the non coverage. Therefore, the company is bound to provide a defense while it delays its ultimate decision. The duty to defend during the period of uncertainty cannot properly be retroactively negated by a subsequent finding of non coverage. Allowing such manipulation of the duty would stand the strong defense duty protections on their head.

10. The Conclusion That the Defective Removal Was Properly Excused Is Inconsistent with the Controlling Law That a Party Seeking to Gain Advantage by Removal Is Put to the Test of Precise Compliance with the Federal Rules of Civil Procedure.

The rule of strict compliance with the mandatory removal procedures is all the more appropriate where a corporation with powerful California presence seeks to use the existence of an out-of-state home office to burden the

federal courts with California coverage law interpretation that is more appropriately determined by the California courts.

A party seeking advantage by removal is put to the test of precise compliance with the Federal Rules of Civil Procedure. As here, where the failure to timely plead results from lack of understanding of rules by the one taking advantage of the removal process, default judgment is appropriate. Savarese v. Edrick Transfer and Storage, Inc. (9th Cir. 1975) 513 F.2d 140, 146.

> "We feel, as did the district judge, that parties who remove cases to the federal courts should become acquainted with and comply with the Federal Rules of Civil Procedure. We see no reason for the federal courts to excuse such professional neglect ...."

Savarese, supra. 513 F.2d at 146.

The insurance company failed to comply with the removal procedure in two ways - (1)it failed to comply with the requirement of timely responding to the complaint within the extended time after removal and (2) the removal itself was procedurally defective in not joining all defendant parties.

Defendant State Farm Fire and Casualty Insurance Company filed its removal papers on January 17, 1996 and therefore its response to summons and complaint would be due by January 22, 1996, five days after removal pursuant to Rule 81(c). Neither insurance company

defendant filed responsive papers prior to the filing of the Request for Entry of Default on January 29, 1996.

The removal papers filed by Defendant State Farm Fire and Casualty Insurance Company were procedurally defective in that there was no joinder by the other defendant, State Farm General Insurance Company. A joinder filed after the removal deadline is not effective, even if the delay was caused by mistake. Doe v. Kerwood (5th.Cir. 1992) 969 F.2d 165, 168.

When the Blums properly presented the clerk with requests for entry of default indicating that defendants had failed to timely file responsive papers after the removal of the action entry of default pursuant to Federal Rule of Civil Procedure 55(a)was mandatory. The clerk did not do so.

The defendant insurance companies moved for an enlargement of time to file a responsive pleading after the time in which to file such pleading had already expired. Federal Rule of Civil Procedure 6(b) requires that a request for discretionary enlargement of time must be made before the relevant period has expired unless the failure to act was the result of "excusable neglect." The insurance companies failed to carry the burden of establishing excusable neglect. See Cuttle v. Federal Employees Metal Trades Council, 623 F.Supp. 1154 (D.Me. 1985).

Assuming arguendo as represented below that a mistake was made as to the deadline extension provision of Federal Rule of Civil

Procedure 81(c), such neglect is not excusable under Rule 6(b). Kyle v. Campbell Soup Company, 13 F.3d 317, 319-321 (9th Cir. 1994); Driver v. Gindy Manufacturing Corporation, 24 F.R.D. 473, 475 (E.D.Pa. 1959). "It is well settled that inadvertence or oversight of the provisions of the federal rules or unfamiliarity with them do not afford an adequate basis for the exercise of discretion by a court for the benefit of the party who fails to observe the rules." Driver , supra., 24 F.R.D. at 475.

The insurance company argued below that it should not be responsible for its attorneys' mistake. The argument is faulty both in that the insurance company fails to establish the factual presumption and in that it is incorrect as to the rule of law which it seeks to apply. The argument presumed that a mistake was made by counsel but did not precisely explain what "mistake" was made and which of its law firms working on the case was the one that made the referenced mistake. Not only did the insurance company fail to carry its burden of establishing that the mistake was of the character of "excusable neglect," it did not even provide enough information for the Court or opposition counsel to independently perform the missing analysis.

A party should normally be responsible for the mistakes of its counsel concerning tardy filing or failures to appear. Pioneer Investment Services Company v. Brunswick, (1993) 507 U.S. 380, 113 S.Ct. 1489, 123 L.Ed.2d 74, 90; United States v. Boyle (1985) 469 U.S. 241; and Link v. Wabash R. Co. (1962)

370 U.S. 626.

CONCLUSION

The Court of Appeals decision in this case departs from the analysis required by controlling law, is contrary to the express language of the policy, is contrary to reasonable expectations of coverage, and is contrary to the parameters of the defense duty ordinarily owed under insurance policies.

The decision sanctions a separate treatment of state coverage law in federal courts in California than received in state courts. The changed approach of this case occurs as a result of determination of issues that were not necessary for the federal court to determine at all in that the removal to federal court was procedurally improper.

The insurance company's Motion to Dismiss should have failed as a product of the same form of error of inadequate analysis that created the defense duty coverage dispute in the first place. Although a defense duty was owed on numerous grounds, the insurance company's coverage analysis avoided fair consideration of its obligation to its policyholders by the sophistry of assuming that all independent tort liability claims of the underlying litigation must succumb to the real estate contract claim that also was raised. It did so despite knowing that there was no privity of contract to support the contract claim, and knowing that the independent tort claims were sufficient to survive even without the contract claims.

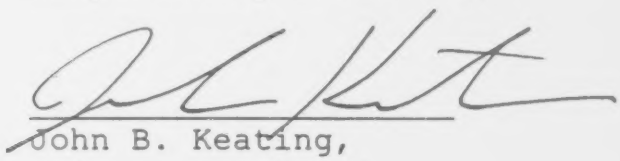
As the Motion to Dismiss similarly failed to consider many of the grounds of liability and bases of coverage presented in the coverage action, it should have been denied as not satisfying the analysis burden requiring it to dispose of all claims presented by the coverage litigation. Even if the insurance company was correct on the argument it asserted, the interests of justice require allowing at least one opportunity to amend to allege the facts of other coverage grounds.

Because the sanctity of the contract and the protection of insurance consumers from an overpowering industry is dependent on requiring full good faith analysis of the defense duty, as is required by California state law and virtually all other federal jurisdictions, the Ninth Circuit Court of Appeals' departure from that rule and from the ordinary course of determination of a motion to dismiss substantially undermines existing insurance coverage law.

Therefore, Petitioners respectfully request that the Supreme Court entertain review of this case.

Dated: February 17, 1999

Respectfully Submitted,



John B. Keating,
Brian B. Beckwith,
Attorneys for Petitioners,
RICHARD H. BLUM and EVA M. BLUM

APPENDIX

Ninth Circuit Order Denying
Petition for Rehearing 2

Published Court of Appeal Judgment 3

Unpublished Court of Appeal Decision . . . 4

District Court Decision 12

NOT FOR PUBLICATION

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

RICHARD H. BLUM and EVA M. BLUM, Plaintiffs-Appellants	)
	) No. C 96-16992
	) D.C. No. CV-96-00259-CAL
v.	)
	) ORDER
STATE FARM FIRE AND CASUALTY COMPANY et al. Defendants-Appellees.	)

Before: WIGGINS and KLEINFELD, Circuit Judges and DWYER, District Judge*

Appellants amended petition for rehearing is denied.

SO ORDERED.

Filed July 31, 1998

* Hon. William L. Dwyer, United States District Judge for the Western District of Washington, sitting by designation.

RICHARD H. BLUM; EVA M. BLUM,
Plaintiffs-Appellants,
vs.
STATE FARM FIRE AND CASUALTY COMPANY; STATE FARM GENERAL INSURANCE COMPANY,
Defendants-Appellees.

No. 96-16992

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

145 F.3d 1336; 1998 U.S. App. LEXIS 19151

November 7, 1997, Argued and Submitted,
San Francisco, California
May 19, 1998, Filed

NOTICE: [*1] DECISION WITHOUT PUBLISHED OPINION

PRIOR HISTORY: Appeal from the United States District Court for the Northern District of California. D.C. No. CV-96-00259-CAL. Charles A. Legge, District Judge, Presiding.

Reported in Full-Text Format at: 1998 U.S. App. LEXIS 10403.

OPINION: AFFIRMED.

RICHARD H. BLUM; EVA M. BLUM,
Plaintiffs-Appellants,
vs.
STATE FARM FIRE AND CASUALTY COMPANY; STATE FARM GENERAL INSURANCE COMPANY,
Defendants-Appellees.

No. 96-16992

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

1998 U.S. App. LEXIS 10403

November 7, 1997, Argued and Submitted,
San Francisco, California
May 19, 1998, Filed

NOTICE: RULES OF THE NINTH CIRCUIT COURT OF APPEALS MAY LIMIT CITATION TO UNPUBLISHED OPINIONS. PLEASE REFER TO THE RULES OF THE UNITED STATES COURT OF APPEALS FOR THIS CIRCUIT.

SUBSEQUENT HISTORY: Reported in Table Case Format at: 1998 U.S. App. LEXIS 19151.

PRIOR HISTORY: Appeal from the United States District Court for the Northern District of California. D.C. No. CV-96-00259-CAL. Charles A. Legge, District Judge, Presiding.

DISPOSITION: AFFIRMED.

COUNSEL: For RICHARD H. BLUM, EVA M. BLUM, Plaintiffs - Appellants: John B. Keating, Esq., Woodside, CA.

For STATE FARM FIRE AND CASUALTY COMPANY, STATE FARM GENERAL INSURANCE COMPANY, Defendants - Appellees: Susan M. Popik, CHAPMAN POPIK & WHITE, Harold A. Weston, KINDER, WUERFEL & CHOLAKIAN, San Francisco, CA.

JUDGES: Before: WIGGINS and KLEINFELD, Circuit Judges and DWYER, District Judge. **

** Hon. William L. Dwyer, United States District Judge for the Western District of Washington, sitting by designation.

OPINION: MEMORANDUM

Richard and Eva Blum appeal the dismissal of their suit against State Farm Fire & Casualty Company and State Farm General Insurance Company (collectively "State Farm"). They sued State Farm for failure to defend the underlying suit brought against the Blums by purchasers of their property. We have jurisdiction under 28 U.S.C. @ 1291, and we affirm.

I.

The duty of an insurer to defend is broader than the duty to indemnify. See Horace Mann Ins. Co. v. Barbara B., 4 Cal. 4th 1076, 1081, 846 P.2d 792 (1993); Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 276-77, 54 Cal. Rptr. 104, 419 P.2d 168 (1966). The insurer has a duty to defend whenever there is any potential for liability within the scope of the insurance policy. See Gray, 65 Cal. 2d at 276-77. Where there is no possibility of coverage, however,

there is no duty to defend. See Miller v. Western Gen. Agency, Inc., 41 Cal. App. 4th 1144, 1152 (1996).

Footnotes

* This disposition is not appropriate for publication and may not be cited to or by the courts of this circuit except as provided by 9th Cir. R. 36-3.

(a)

Appellants argue that their personal liability umbrella policies covered the claims against them in the underlying complaint. The policies, however, limit coverage to liability resulting from a "loss," which was defined as an "accident." Under California law, insurance [*3] coverage limited to liability from an accident does not extend to claims based on misrepresentations or a failure to disclose. See Miller, 41 Cal. App. 4th at 1149. Therefore, most of the claims against the Blums in the underlying complaint were not covered by the umbrella policies because they were based either on alleged misrepresentations or on failures to disclose.

The remaining two claims are titled "negligence" and "negligent infliction of emotional distress." Despite their titles, they are both based squarely on the contract between the Blums and the underlying plaintiffs. Specifically, the duty element in both claims could only arise from the contractual relationship. California courts have definitively held that the language "legally obligated to pay damages" in an insurance contract limits coverage to tort

liability only, prohibiting coverage of contract liability. See, e.g., Fragomeno v. Insurance Co. of the West, 207 Cal. App. 3d 822, 828, 255 Cal. Rptr. 111 (1989); Stanford Ranch, Inc. v. Maryland Cas. Co., 89 F.3d 618 (9th Cir. 1996) (interpreting California law). Under California law, a claim sounds in contract, not tort, when it is dependent on the existence [*4] of an underlying contract. See Insurance Co. of the West v. Haralambos Beverage Co., 195 Cal. App. 3d 1308, 241 Cal. Rptr. 427 (1987); Stanford Ranch, 89 F.3d at 625. The "negligence" and "negligent infliction of emotional distress" claims were based on the underlying land sale contract; therefore, they sound in contract, not tort, and are not covered by the umbrella policies.

(b)

The Blums also argue that the homeowners insurance policies covered the underlying claims. As previously discussed, most of the claims against the Blums were based on either misrepresentations or failure to disclose and, therefore, do not fall within the definition of "occurrence" as an "accident." See Miller, 41 Cal. App. 4th at 1149.

Similarly, the claim for negligent infliction of emotional distress was not covered by the policy because that policy only covered damages for "bodily injury or property damage," the definition of which explicitly excluded emotional distress.

Appellants attempt to characterize the

negligence claim as a "negligent construction" claim based in tort, not contract. The technical legal title of a claim is not controlling; rather, the court must look at the underlying [*5] facts on which the claim is based. See Wilmington Liquid Bulk Terminals, Inc. v. Somerset Marine Inc., 53 Cal. App. 4th 186, 193-94 (1997), rev. den. May 21, 1997; Chamberlain v. Allstate Ins. Co., 931 F.2d 1361, 1365 (9th Cir. 1991); Chmura v. Allstate Ins. Co., 1997 U.S. Dist. LEXIS 8641, 1997 WL 431093 (C.D. Cal.).

The "negligence" claim in the underlying complaint was based on the same facts as the other claims: a contractual duty to disclose, a failure to disclose, and misrepresentations. Therefore, it was based on a breach of the contractual duty to disclose. See Allstate Ins. Co. v. Hansten, 765 F. Supp. 614, 616 (N.D. Cal. 1991) (reaching the same conclusion on identical facts). Because an occurrence-based liability policy does not cover contract claims, the negligence claim was not covered by the homeowners policy.

In addition, the negligence claim was not a claim for damages "caused by an occurrence," because negligent misrepresentations are not "occurrences" within the meaning of insurance liability policies. See Miller, 41 Cal. App. 4th at 1150; Chatton v. National Union Fire Ins. Co., 10 Cal. App. 4th 846, 861 (1992); Safeco Ins. Co. v. Andrews, 915 F.2d 500, 502 [*6] (9th Cir. 1990). Therefore, the negligence claim was not covered by the Blums' homeowners policies.

Because the underlying complaint did not state a claim covered by State Farm's policies with the Blums, State Farm did not have a duty to defend the Blums. The district court's dismissal of the duty to defend action against State Farm is affirmed.

II.

Appellants ask this court to hold that the district court improperly dismissed their entire action when it dismissed their duty to defend claim against State Farm. In addition to their duty to defend claim, Appellants asserted a variety of claims based on breach of contract.

California law is clear: when there is no potential for coverage under an insurance policy (and therefore no duty to defend), there cannot be an action for breach of the implied covenant of good faith and fair dealing. See Waller v. Truck Ins. Exch., 11 Cal. 4th 1, 36, 900 P.2d 619 (1995). Moreover, when there is no duty to defend, a lengthy delay cannot constitute bad faith. See Love v. Fire Ins. Exch., 221 Cal. App. 3d 1136, 1153, 271 Cal. Rptr. 246 (1990). These holdings support the dismissal of all Appellants' claims, because they are based on the presumption [*7] of a contractual duty to defend. Without such a duty, none of their claims have merit.

III.

Appellants also request the court to find that the district court clerk's decision not

to enter a default judgment was erroneous. Although the clerk should have entered a default judgment under Federal Rule of Civil Procedure 66(a), the error was harmless under Rule 61. Our refusal to set aside the judgment is not "inconsistent with substantial justice," Fed. R. Civ. Pro. 61, given that Appellants have not shown prejudice or an effect on their "substantial rights" from the failure to enter default.

IV.

Appellants also ask us to find that the district court erred by allowing State Farm an extension of time to file its responsive pleading in federal court. A district court may extend the filing time after the time has expired when the failure to file was the result of excusable neglect. See Fed. R. Civ. Pro. 6(b)(2). The district court's decision to grant a time extension under Rule 6(b)(2) is reviewed for an abuse of discretion. See Fed. R. Civ. Pro. 6(b).

Although the district court did not make an explicit finding of excusable neglect in its order, it did find "good cause." The [*8] district court thus implicitly found excusable neglect in its grant of a time extension. The district court had a valid basis for a finding of excusable neglect in the declaration from State Farm's counsel describing the reason for the failure to file a response. Appellants have made no showing of prejudice, State Farm made a prompt motion for an extension of time once counsel had actual notice of the deadline, and State Farm produced evidence of

a valid reason for delay. See Rodgers v. Watt, 722 F.2d 456, 460 (9th Cir. 1983) (en banc) (holding that these are three of the four factors to consider in excusable neglect under Rule 60(b)).

Given that "there is a compelling interest in the finality of judgments which should not lightly be disregarded," Rodgers, 722 F.2d at 459, we will not now set aside the judgment of the district court on the merits because its finding of excusable neglect was not explicit. Appellants have failed to make a showing of an abuse of discretion by the court.

AFFIRMED.

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

RICHARD H. BLUM and EVA M. BLUM, Plaintiffs,	
	No. C 96-0259 CAL
	ORDER OF DISMISSAL
v.	
STATE FARM FIRE AND CASUALTY COMPANY et al. Defendants	

Defendants State Farm Fire and Casualty Company and State Farm General Insurance company filed a motion to dismiss the First Amended Complaint for failure to state a claim. The motion was briefed, argued at hearings on April 5 and 26, 1996, and submitted. Having reviewed the moving, opposing, reply, and supplemental briefs, the record of the case, and relevant authorities, the court orders as follows.

I.

Plaintiffs' complaint seeks defense costs and indemnity for an underlying suit brought by purchasers and subsequent owners of plaintiffs' residence. Plaintiffs seek coverage under homeowners' policies and umbrella policies issued by State Farm Fire and Casualty Company from August 1985 to March 1995. The policies are attached as exhibits to

the complaint. Interpretation of an insurance contract is a matter of law for the court. The court therefore rules on the coverage issues under the standard of Fed. R. Civ. P. 12(b)(6).

II.

Plaintiffs converted a room in their home into a garage and second floor office and installed fuel storage tanks and fuel lines. Subsequent owners of the home discovered that the storage tanks and fuel lines had leaked damaging the property. The subsequent owners sued plaintiff for this damage and other alleged defects. The suit claims for breach of contract, negligence, breach of violations of California Civil Code §1102.13, fraud, negligent misrepresentation, negligent failure to inspect, breach of fiduciary duty, negligent construction, negligent infliction of emotional distress, intentional interference with prospective economic advantage, and strict liability. Plaintiffs tendered the defense and indemnity of the underlying action to defendant State Farm, which denied coverage and a defense. ultimately, a binding arbitration award of $222,566 was entered against plaintiffs and in favor of the subsequent owners.

III.

The duty to defend is broader than the duty to indemnify. Gray v. Zurich Ins. Co., 65 Cal. 2d 263, 276-77(1966). The insurer has a duty to defend whenever there is the potential

of liability under the policy. Id.

Whether an insurer owes a duty to defend must be determined "by comparing the allegations of the complaint with the terms of the policy." Id. at 276. "For an insurer, the existence of a duty to defend turns not upon the ultimate adjudication of coverage under its policy of insurance, but upon those facts known by the insurer at the inception of a third party lawsuit. Hence, the duty 'may exist even where coverage is in doubt and ultimately does not develop" Saylin v. California Ins. Guarantee Ass'n, 179 Cal. App. 3d 256, 263 (1986).

The respective burdens of the insured and insurer in a duty to defend action are as follows:

> To prevail, the insured must prove the existence of a potential for coverage, while the insurer must establish the absence of any such potential. In other words, the insured need only show that the underlying claim may fall within policy coverage; the insurer must prove it cannot. Facts merely tending to show that the claim is not covered, or may not be covered, but are insufficient to eliminate the possibility that resultant damages (or the nature of the action) will fall within the scope of coverage, therefore add no weight to the scales.

Montrose Chemical Corp. v. Superior Court,
6 Cal. 4th 287, 300 (1993)

IV.

Plaintiffs' homeowner policies were "occurrence" based policies that provided personal liability limits of $100,000 per occurrence. The language of Homeowners' Policy No. 05-67-5258-2, in effect from August 1985 to December 1986 (the period during which plaintiffs sold their home) is cited in the First Amended Complaint. Under "Coverage L - Personal Liability," the policy provided indemnity and defense

> [i]f a claim is made or a suit is brought against an insured for damages because of bodily injury or property damage to which this coverage applies, caused by an occurrence,. . . .

First Amended Compl. ¶16.

The policy defines "occurrence" as "an accident, including exposure to conditions, which results in:

a. bodily injury; or
b. property damage during the policy period. Repeated or continuous exposure to the same general conditions is considered to be one occurrence.

Property damage is defined in the policy as "physical damage to or destruction of tangible property, including the loss of use of this property."

The policies also contains two relevant exclusions. First, the policies exclude from liability coverage "property damage to property owned by an insured." Second, liability coverage is excluded if it arises out of "business pursuits"or rendering or failing to render "professional services. "including" physical including:

A.

At the time that plaintiff's did the reconstruction, they owned and occupied the property. The subsequent owners had no interest in the property at that time. Their claim arises from the fact that plaintiffs sold them property which was defectively constructed. Their claim, however phrased in the causes of action, arises from plaintiffs' sale of the property to them. Defendants argue correctly that plaintiffsare seeking coverage under the homeowner's policies for contractual damages arising out of the sale of their home. There is no coverage under a homeowner's policy for claims arising from the sale and misrepresentation of the condition of real property. In the terms of the policy, there was no "accident" or "occurrence," and no injury to s1tangible11property. The only injury suffered by the subsequent owners was economic.

Allstate Ins. Co. v. Chancy, 804 F. Supp. 1219 (N.D.Cal. 1992), addressed the issue of whether an insurer has a duty to defend misrepresentation claims arising from the sale of real property. In Chaney, the buyer sued for"intentional misrepresentation, concealment, negligent misrepresentation, negligence, breach of fiduciary duty, intentional infliction of emotional distress, negligent infliction of emotional distress, breach of contract, and constructive trust" Id. at 1220. In the coverage action, the insured argued that damages resulting from the alleged misrepresentations were unintended, and therefore, an "accident" within the meaning of the policy. Id. at 1221. The court found that "negligent misrepresentations made in conjunction with the sale of property [do] not qualify as an "accident" for insurance coverage purposes. Id. at 1221. The court therefore found that there was no "occurrence" and that the insurer had no duty to defend or indemnify the insured. Id. at 1222. The homeowner's policy in Chaney was similar to those in the instant case: it provided coverage for "bodily injury or property damage arising from an accident." Chaney, 804 F. Supp. at 1220.

Similarly, in Warner v.Fire Ins. Exchange, 230 Cal. App. 3d 1029 (1991), the court found that the policy did not cover the buyers' claims for damages for negligent misrepresentations made by the insureds in selling the property because there was no damage to "tangible property" during the time that the policy was in effect. Id. at 1036; see also Miller v. Western General Agency,

1996 Cal. App. LEXIS 28 (1996) (misrepresentation caused economic loss rather than injury to tangible property); Devin v. United Services Auto Ass'n, 6 Cal. App. 4th 1149, 1159 (1992) (same); Allstate Ins. Co. v. Miller, 743 F. supp. 723, 727 (N.D. Cal. 1990) (same).

Accordingly, the claims by the subsequent owners against plaintiffs that they misrepresented and concealed the condition of the property are not claims for an "occurrence"triggering either a duty to defend or to indemnify.

B.

Plaintiffs argue that the policies provide coverage for the negligence, negligent construction and negligent infliction of emotional distress claims in the underlying suit (Second, Seventh, Nineteenth, and Twentieth Causes of Action) In the Nineteenth Cause of Action the subsequent owners alleged negligent construction in that the Blums failed to"render the construction improvements, additions, renovations . . . in a manner which met reasonable and professional standards applicable to building professionals." In the Twentieth Cause of Action (negligent infliction of emotional distress), the subsequent owners allege that plaintiffs'failure to exercise due care caused emotional distress.

In Allstate Ins. Co. v. Hansten, 765 F. Supp. 614 (N.D.Cal. 1991), the court considered whether the insurer had a duty to

defend or indemnify the insureds in an action brought by purchasers of the insureds' home. With respect to the negligence cause of action, which alleged that the insureds failed to exercise ordinary care as a builder, the court found that the alleged harm necessarily arose from the contract to sell the house. Without the contract, the insureds would have had no duty of care towards the buyers. Therefore, the duty alleged to have been breached was a contractual duty, and the policy did not cover such losses.'s at 616. With respect to the negligent infliction of emotional distress claim, the court found that this claim also arose from a duty created by the contract. Absent the contract, there could be no claim for misrepresentation, negligent construction or related emotional distress. Id. at 617.

As the state court of appeal stated in Miller v Western General:

> "[I]t now appears to be clearly settled in California that occurrence based liability policies were never intended to cover emotional distress damages that flow from an uncovered occurrence and an insured could not reasonably expect coverage or a defense merely because a claim of emotional or physical distress is alleged as a result of an economic loss".

1996 Cal. App. LEXIS at *12-13.

In the underlying complaint here, the

causes of action cited above are captioned "Negligence." But coverage is based on the factual allegations of the underlying complaint, not "how the third party denominates its complaint or frames its theories." Devin v. United Servs. Automobile Assn, 6 Cal. App. 4th 1149, 1157 (1992). Here, the alleged harm to the subsequent owners could not have occurred without the sale of the house to them. The duty alleged to have beenbreached arose from the contract. The causes of action labeled "Negligence" upon duties created by the contract of sale. Accordingly, the alleged negligence claims would notbe covered or, for purposes of the duty to defend, potentially covered as an "occurrence" under the homeowner's policy.

C.

Plaintiffs also sue on an umbrella policy issued by defendants. The umbrella policy in effect from August 22,1986, to August 22, 1987, provided a $2,000,000 limit for "Coverage L Personal Liability. The policy provided, irrelevant part:

> Coverage L -- Personal Liability. If you are legally obligated to pay damages for a loss, we will pay your net loss minus the retained limit.

(First Amended Compl., App. A at 269).

Loss is defined in the policy as "an accident that results in personal injury or property damage during the policy period" (underline added). Since the homeowner's

policy defined an "occurrence" as an "accident," the coverage under the umbrella policy is, for purposes of this motion, coextensive with the homeowner's policies. The underlying complaint does not allege an "accident" causing personal injury or property damage. The defective construction was made to the residence that plaintiffs then owned and was not an " accident." There is no coverage or duty to defend under the umbrella policy.

D.

Plaintiffs rely on a line of cases which held that industrial pollution constituted an "occurrence" under liability policies. These cases are inapposite, however, because they involved pollution which affected property owned by third persons, such as groundwater and neighboring property. For this reason, plaintiffs' reliance on, among other cases, IMCERA Group, Inc. v. Liberty Mut. Ins. Co., 50 Cal. Rptr. 2d 583 (Ct. App. 1996), is unavailing. The underlying suit against the insured in IMCERA sought damages caused by groundwater contamination and damage to property other than the facility formerly owned by the insured. That is not the case here.

E.

Plaintiffs cite another line of cases holding that negligent construction which causes damage to property after its sale is an "occurrence." For example, plaintiff cites Maryland Cas. Co. v. Reeder, 270 Cal. Rptr. 719 (Ct. App.1990), in which the court found coverage for the developer in a suit brought

by purchasers of condominiums for damage due to alleged improper grading of lots. Even this theory cannot provide coverage to plaintiffs in the present case. If plaintiffs were sued as "developers," the claims would clearly fall within the "business pursuit" or professional services exclusions of these homeowner's policies.

F.

Plaintiffs' claim for breach of the implied covenant of good faith and fair dealing must fail in the absence of coverage or a duty to defend. "Where benefits are withheld for proper cause, there is no breach of the implied covenant. The duty imposed by law is not unreasonably to withhold payments due under the policy." Love v. Fire Ins. Exchange, 221 Cal. App. Sd 1136, 1151 (1990). Because there is no basis for coverage, State Farm's refusal to defend and indemnify the Blums does not amount to bad faith.

The court also finds that the complaint makes no allegations against nominal defendant State Farm General Insurance Company. This company does not appear on the declaration pages of the policies. Accordingly, the motion to dismiss against State Farm General Insurance Company is also GRANTED on this independent ground.

For the foregoing reasons, the court ORDERS that the First Amended complaint is DISMISSED without leave to amend.

IT IS SO ORDERED.
Dated: July 17, 1996